



Status Report MTC Project on Taxation of Partnerships

November 9, 2021

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MULTISTATE TAX COMMISSION

Background

- At its meeting in April 2021, the Uniformity Committee took up a project on state taxation of partnerships based on the recommendations of the Standing Subcommittee that a work group be established to consider:
 - Sourcing of partnership operating income and partnership items for state tax purposes;
 - Sourcing and taxation of gains and losses from the sale of partnership interests;
 - Entity level taxation issues including transfer pricing or combined filing issues; and
 - Other administrative and enforcement issues including information reporting and withholding.

Project Work Group

- Established a project web page
- Met bi-weekly
- Agreed on a process
- Began work on a comprehensive issue outline
- Surveyed the work group on most important issues and where to start

Project on State Taxation of Partnerships

PROJECT DESCRIPTION

Project on State Taxation of Partnerships

At its meeting in April 2021, the Uniformity Committee took up a project on state taxation of partnerships based on the recommendations of the Standing Subcommittee that a work group be established to consider:

1. Sourcing of partnership operating income and partnership items for state tax purposes;
2. Sourcing and taxation of gains and losses from the sale of partnership interests;
3. Entity level taxation issues including transfer pricing or combined filing issues; and
4. Other administrative and enforcement issues including information reporting and withholding.

PUBLIC NOTICE & AGENDA

Partnership Tax Work Group - Current Meetings and Information
The work group will hold regularly scheduled bi-weekly meetings - Tuesdays at 2:00 P.M. Eastern

Next Meeting

Tuesday, October 26, 2021

(Note - There will be no meeting on November 9 since the Uniformity Committee is meeting that day.)

All meetings are 2:00 - 3:00 P.M. Eastern

Log-in/Dial-in Information

Join from your computer, tablet or smartphone.

<https://www.gotomeet.me/LilaDisque/work-group--state-taxation-of-partnerships>

You can also dial in using your phone.

United States: +1 (877) 240-3412

Access Code: 208-267-469

*Telephone participants will be muted if their line causes interference with the call; to un-mute your line, please press *6.
If you experience any kind of difficulty participating in the meeting, please contact [Lila Disque](#) or [Chris Barber](#).*

AGENDA

- I. Welcome & Introductions
- II. Initial Public Comment
- III. [Review Updated Outline - As of October 18, 2021](#) with minor corrections (starting at p. 45) [Slides for Meeting](#)
- IV. Review of Survey Results and Discussion of Recommendation to Uniformity Committee
- V. Adjourn

MEETING ARCHIVE

- [Review of Updated Outline - As of October 2, 2021](#) and [Slides for Meeting](#)
- [Review of Updated Outline - As of September 23, 2021](#) and [Slides for Meeting](#)
- [Review of Updated Outline - As of September 8, 2021](#) and [Slides for Meeting](#)
- [Review of Updated Outline - As of August 26, 2021 - Slides for Meeting](#)
- [Outline - As of August 10, 2021](#)
- [Slides for First Partnership Work Group Meeting - June 15, 2021](#)
- [Staff Report - Partnership Issue Outline \(March 2020\)](#) - [Word Version - Partnership Issue Outline](#)
- [Recommendation on the Project from the Standing Subcommittee](#)

RESEARCH AND OTHER MATERIALS

General Information and Analysis

- Walter Hellerstein, "Substance and Form in Jurisdictional Analysis: *Corriagn v. Testa*" (State Tax Notes) - June 13, 2016
- [2004 - MTC Pass-Through Entity Compliance Work Group Report and Proposed Initiatives](#)
- Martin J. McMahon, Jr., "Rethinking Taxation of Privately Held Businesses," (ABA, The Tax Lawyer) - Winter 2016
- [Original Proposal to Adopt Uniform Composite & Withholding Provisions - 1992](#)

Pass-Through Entity (PTE) Taxes - Information and State Guidance

General Information:

- [Article on State PTE Taxes \(Wlodychak - State Tax Notes\)](#) - August 2021
- [IRS Notice 2020-75](#) - Forthcoming Regulations Regarding the Deductibility of Payments by Partnerships and S Corporations for Certain State and Local Income Taxes

State Agency Information or Legislation:

- [Alabama - PTE Info - Agency Website](#)
- [Arizona - Senate Bill 1783](#)
- [Arkansas - House Bill 1209](#)
- [California ETP - PTE Info - Agency Website](#)

General Approach to Project

1. Identify and generally describe a comprehensive list of potential issues. (Status – started.)
2. Note the important relationships between those issues. (Status – started.)
3. Select a particular issue and develop a set of generally recommended practices or positions for addressing that issue.
4. Repeat step 3 until all major issues have a set of recommended practices/positions, revising earlier issues if necessary to reconcile any differences.
5. Agree on the overall set of recommended practices/positions for all issues—the detailed work plan.
6. Begin creating draft models, etc., to carry out the recommended practices/positions—putting forward those that are ready for adoption.

Detailed Outline of Issues

- High-level review of most critical issues affecting state taxation of partnerships.
- Currently at 56 pages.
- Prepared in outline form—provided in Word on the project page.

Nature of Issues & Examples

Complex Issues without Clear Solutions

- Example: Application of general rules to tiered partnership structures.

Divergent Policies

- Example: Treatment and sourcing of guaranteed payments.

Uniform Policies

- Example: Sourcing of income from “investment partnerships.”

Emerging Issues

- Example: Treatment of PTE taxes.

Relationships

- Often time issues are related:
 - The apportionment rules for partnerships generally might be used to source the sale of a partnership interest.
 - The conformity to federal tax rules may affect partnership income and also partner attributes.
 - Conformity to Subchapter K raises particular issues for states in various areas—including the ability to use anti-abuse rules to address state-level issues.

General Areas

Taxation of Operating Income

- Nexus and Imposition
- Tax Base – Federal Conformity – Related Issues
- Sourcing and Credits for Taxes Paid

Taxation of Sales of Partnership Interests

- Nexus
- Tax Base – Computation of Gain/Loss
- Sourcing and Credits for Taxes Paid

Administration and Enforcement

- Information Reporting
- Withholding
- PTE & Composite Returns
- Audit and Adjustment

Some of the Bigger Issues (from Outline)

- 2.1.2.2. Question – May a state impose reporting requirements on a partnership if its only connection to the state is an indirect or limited/passive partner?
- 2.1.5.2. Question – Does the nature of the partner affect nexus to tax that partner?
- 2.1.6.1. Whether states have constitutional authority to tax certain partnerships or partners, states may also statutorily exclude some types of partners or partnership activity from their doing business or tax imposition provisions.

Some of the Bigger Issues (from Outline)

- 2.2.2.1. Question – Have states considered the implication of conforming to the federal treatment of certain payments (“guaranteed payments”) to partners?
- 2.2.2.2. Question – Have states considered the tax implications of conforming to special allocations of partnership items?
- 2.2.2.3. Question: Have states considered the implication of conforming to federal rules for treating built-in gain or loss on contributed property?
- 2.2.2.4. Question: Have states considered the implication that federal rules allow partners to offset income and loss from different partnerships or other sources?

Some of the Bigger Issues (from Outline)

- 2.2.2.5. Question: Are there cases involving related-company income or gains and losses where states may need to limit partners ability to offset those items?
- 2.2.2.6. Question: Does general conformity to federal partnership anti-abuse rules suffice to protect states from income shifting or other unintended tax effects?
- 2.2.2.7. Question: How would state conformity affect the ability to apply other general federal anti-abuse rules?
- 2.2.3.1.1. Question: Does IRC § 482, which governs the transfer pricing of related-party transactions, apply to related partnerships?

Some of the Bigger Issues (from Outline)

- 2.2.3.1.3. Question: Do state add-back statutes apply to transactions between related partnerships?
- 2.2.3.1.4. Question: Would UDITPA Section 18 equitable apportionment authority apply when sourcing partnership income effected by intercompany transactions?
- 2.3.11.1.1. Question: What information is used to determine if partnership income or items are business (apportionable) versus nonbusiness (nonapportionable) income?
- 2.3.11.1.2. Question: Assuming partnership income or items are nonbusiness (nonapportionable) income, what information is used to source that income or item?

Some of the Bigger Issues (from Outline)

- 2.3.11.1.3. Question: Assuming partnership income or items are business (apportionable) income, what information is used to source that income or item? (Does it matter if partners are individuals, corporations, or tiered partners?)
- 2.3.11.2. Question: Does the role or status of partners in the partnership affect sourcing?
- 2.3.11.3. Question: Should states consider providing different sourcing treatment for income of operating versus investment partnerships?

Some of the Bigger Issues (from Outline)

- 2.3.11.4. Questions and Issues: How can states conceptualize the issues involved in sourcing partnership income so as to provide specific guidance?
 - Type of partnership – operating or investment
 - Type of partner – individual, corporate, or tiered
 - Type of income or distribution – distributive share, special allocations, guaranteed payments, allocation of built-in gain/loss
 - Do the rules need to be consistent with the sourcing of income at the partnership level (for composite return and PTE taxes)?

Some of the Bigger Issues (from Outline)

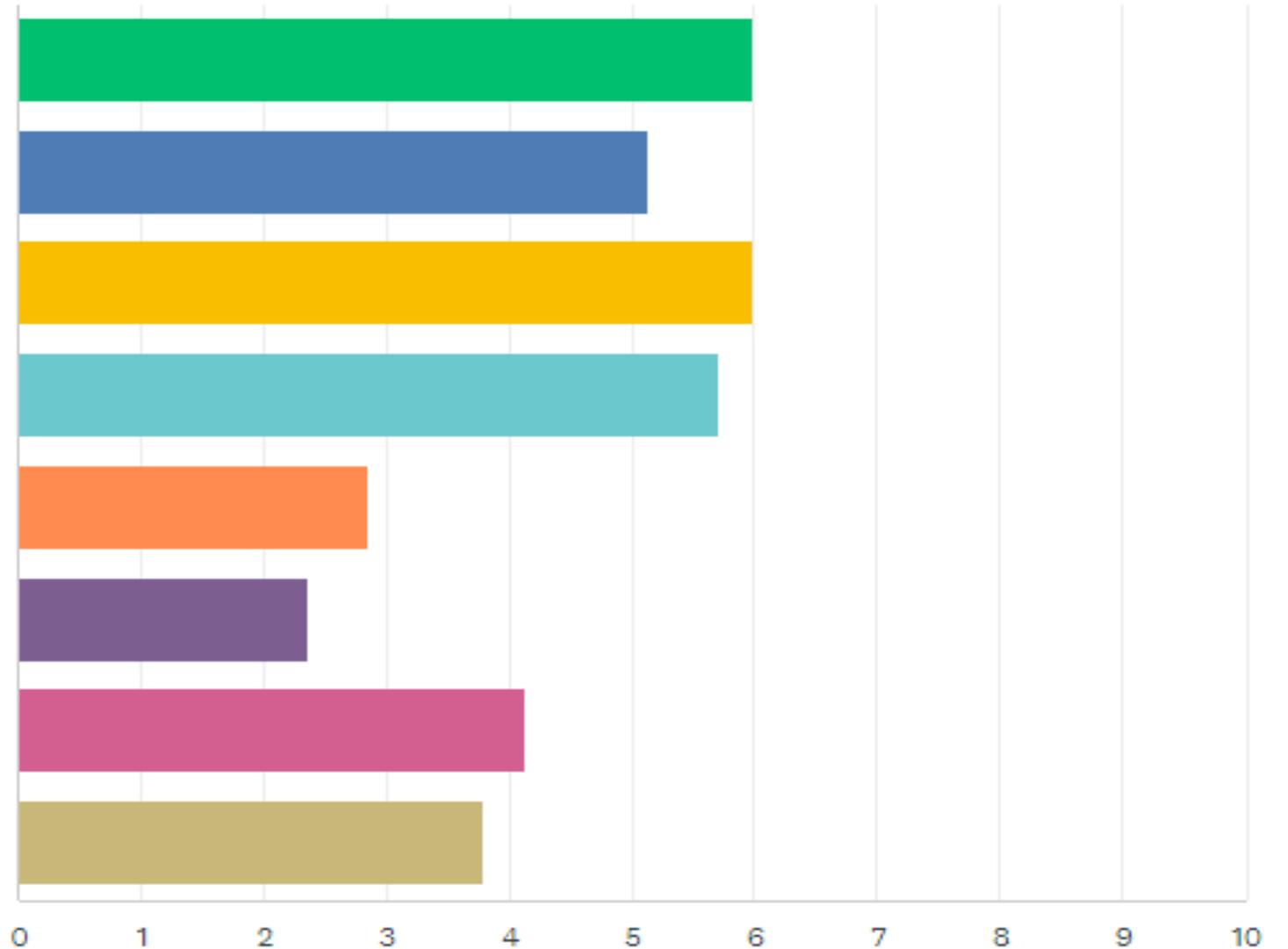
- 3.1.1.2.2. Question: How do state definitions of business income and the unitary business principle determine whether a partner is subject to tax on the gain resulting from the disposition of a partnership in the state?
- Also, what rules do states currently use for sourcing gain/loss on sale of partnership interest and what issues does this raise.
- 4.1.3.1. State information reporting should address state adjustments to partnership operating income – whether reported at partnership or partner level.
- 4.1.3.2. State information reporting, unlike federal reporting generally, must also address the sourcing of partnership income.
- 4.1.3.3. Complications for information reporting when tiered partner sourcing information is used.

Some of the Bigger Issues (from Outline)

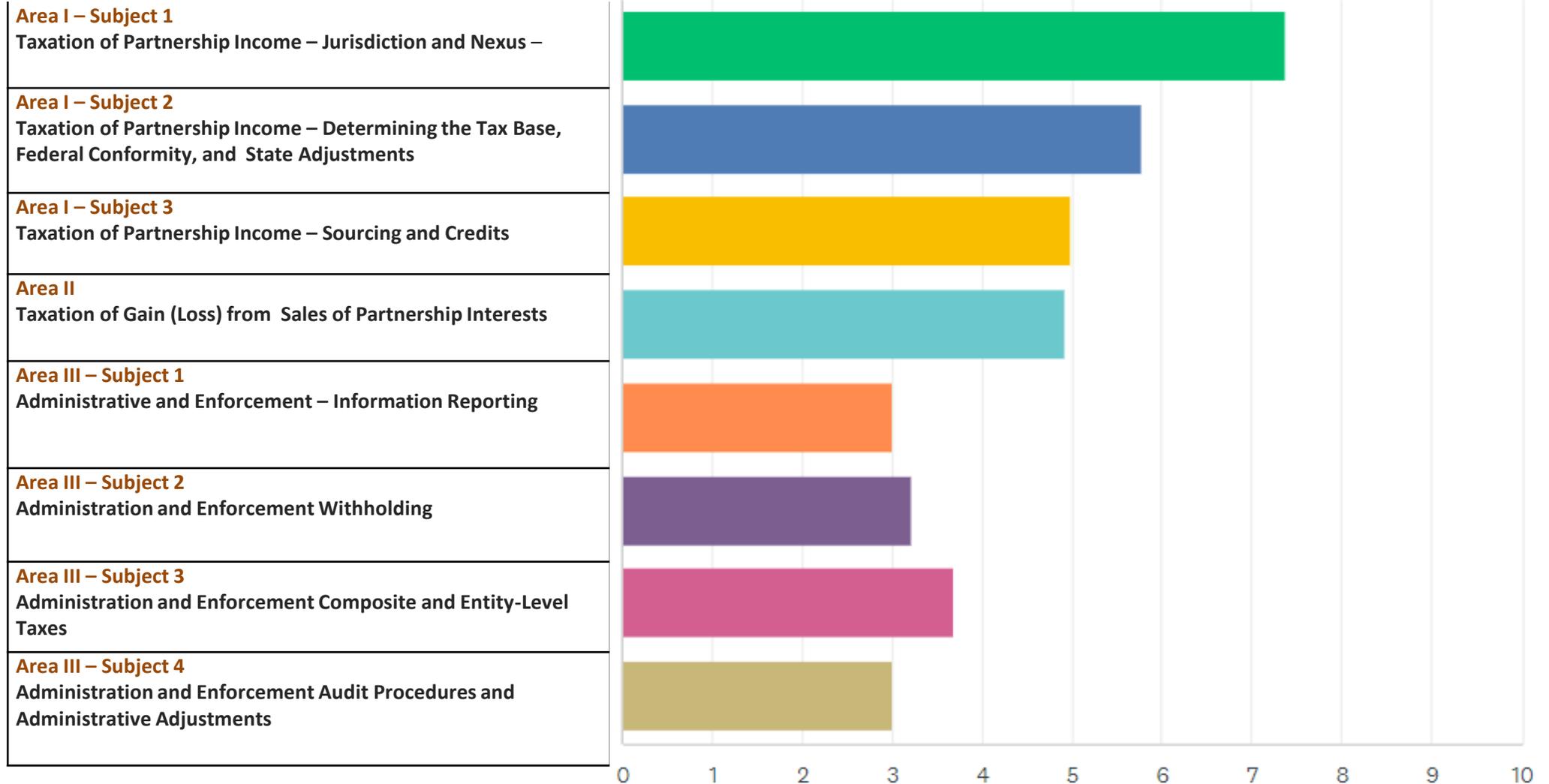
- 4.1.5. Requirement for Consistency in Reporting (do states need one)
- 4.2.1.2. Possible updates to the MTC model withholding and composite return statute
 - 4.2.1.2.2. Best practices - withholding requirements
 - 4.2.2.2. States that source gains from sales of partnership interests on an apportionment basis may wish to consider withholding requirements.
- 4.3.3.1. There are a number of variations in how state composite or PTE taxes work.
- 4.3.4.2. States may want to consider partnership-level audits for state issues.

Survey Results - Most Important?

Area I – Subject 1 Taxation of Partnership Income – Jurisdiction and Nexus –
Area I – Subject 2 Taxation of Partnership Income – Determining the Tax Base, Federal Conformity, and State Adjustments
Area I – Subject 3 Taxation of Partnership Income – Sourcing and Credits
Area II Taxation of Gain (Loss) from Sales of Partnership Interests
Area III – Subject 1 Administrative and Enforcement – Information Reporting
Area III – Subject 2 Administration and Enforcement Withholding
Area III – Subject 3 Administration and Enforcement Composite and Entity-Level Taxes
Area III – Subject 4 Administration and Enforcement Audit Procedures and Administrative Adjustments

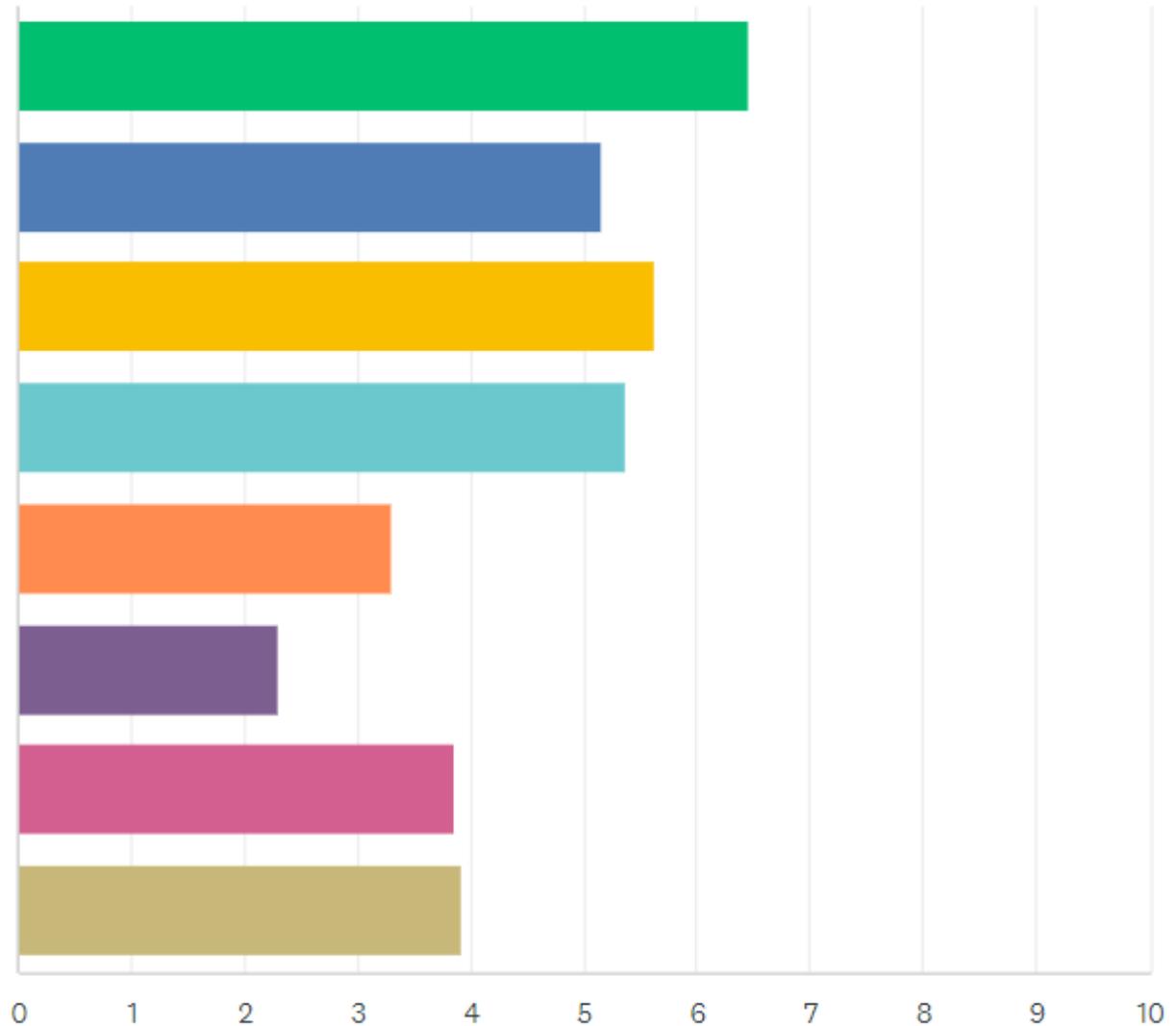


Survey Results – In What Order?



Survey Results – Training Needs?

Area I – Subject 1 Taxation of Partnership Income – Jurisdiction and Nexus –
Area I – Subject 2 Taxation of Partnership Income – Determining the Tax Base, Federal Conformity, and State Adjustments
Area I – Subject 3 Taxation of Partnership Income – Sourcing and Credits
Area II Taxation of Gain (Loss) from Sales of Partnership Interests
Area III – Subject 1 Administrative and Enforcement – Information Reporting
Area III – Subject 2 Administration and Enforcement Withholding
Area III – Subject 3 Administration and Enforcement Composite and Entity-Level Taxes
Area III – Subject 4 Administration and Enforcement Audit Procedures and Administrative Adjustments



Next Steps

3. Select a particular issue and develop a set of generally recommended practices or positions for addressing that issue.
4. Repeat step 3 until all major issues have a set of recommended practices/positions, revising earlier issues if necessary to reconcile any differences.

Staff suggestion:

- Focus on providing training and information sessions
- Tackle issues ready to be addressed – for example: investment partnerships